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No. 08-1134

Supreme Court, U.S.
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In The
Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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INTRODUCTION

Congress has mandated a tripartite ordering of debts that may be dischargeable in bankruptcy. Debts in the first category – ordinary debts – are fully dischargeable. 11 U.S.C. § 1328(a). Debts in the second category – those for credit fraud, fraud or defalcation while acting as a fiduciary, embezzlement, or larceny – are dischargeable *unless* the creditor objects. 11 U.S.C. § 523(c). And debts in the third category – student loans, certain taxes and customs duties, drunk-driving death or personal injury liabilities, criminal fines and restitution, and alimony and child support, – are excepted from discharge, *even if* the creditor does not object. 11 U.S.C. §§ 523(a) and 1328(a)(2) and (3).

Student loan debts fall into the third statutory category, and are not dischargeable unless the court finds undue hardship through an adversary proceeding after appropriate notice. 11 U.S.C. § 102(1)(A); FED. R. BANKR. P. 7001, 7004(a)-(b). The effect of the Ninth Circuit rule is to transform debts in the third category into debts in the second category – to make all enumerated debts fully dischargeable *unless* the creditor objects. That outcome cannot be reconciled with the statutes.

Congress has directed that the exception is self executing: the statutory language provides that, absent a finding of undue hardship, a bankruptcy discharge "*does not discharge* an individual debtor for any debt" for student loans. 11 U.S.C. § 523(a)(8)

(emphasis added). That congressional language is addressed not only to the bankruptcy court, but to the legal *effect* of the order; it mandates that, as a matter of law, a noncompliant discharge "does not discharge" student loan debts.

Safeguarding against what the Ninth Circuit has allowed here, Congress has also prohibited debtors from including provisions in Chapter 13 plans that are inconsistent with the Bankruptcy Code. 11 U.S.C. § 1322(b)(11). Moreover, Congress has withheld authority from the bankruptcy courts to confirm plans that do not comply with the Code or to discharge debts that fall into the above-described third category even though specifically "*provided for by the plan*." 11 U.S.C. § 1325(a)(1); 11 U.S.C. § 1328(a)(2) (emphasis added).

Espinosa argues, contrary to the text of the statutes, that his noncompliant order in fact *did discharge* his student loan debt. That argument cannot be squared with the text, purpose and structure of the Code.

Espinosa's principal arguments sound in waiver. And yet a party cannot waive, by failing to object, a statutory right for which Congress has provided that no objection is necessary to preserve. Nor can a party waive a statutory prohibition on the legal effect of an order.

For those reasons, *res judicata* does not bar consideration of the Rule 60(b) motion. The instant case is not a collateral attack on a final judgment. It

is a direct motion to set aside a judgment that was void *ab initio* under the Code.

Were it otherwise, the necessary result would be to open the door to "discharge by declaration" for every category of excepted debt. Given the possibility of getting those debts discharged unawares, debtors' counsel would be obliged to routinely attempt to do so. And that, in turn, would necessitate thousands and thousands of *pro forma* objections by creditors otherwise protected by statute, and every one of those objections would then be upheld – returning to the *status quo ante* after an enormous waste of time and resources. To this nonsensical result, Espinosa has no response. That silence is revealing.

As the federal, state, and municipal *amici* in this case have powerfully underscored, no good purpose is served by requiring thousands of creditors to file boilerplate objections, and spend considerable resources, just to preserve the current statutory exceptions. No practical benefit would arise. Such a regime would disserve creditors, disserve the judicial system, and even disserve debtors, who would simply face delay and added expense through pointless procedure.

Far better it would be to enforce the statutory text as written, discourage litigation gamesmanship, and preserve the exceptions to discharge that Congress has mandated.

ARGUMENT

I. THE BANKRUPTCY COURT LACKED AUTHORITY TO CONFIRM A PLAN THAT PURPORTS TO DISCHARGE STUDENT LOAN DEBT WITHOUT A FINDING OF UNDUE HARDSHIP.

Initially, Espinosa seeks to avoid the ultimate issue by contending that "[u]nless and until" USA Funds "can prevail in setting aside the judgment," USA Funds' "merit-based arguments are irrelevant." Br. at 18. Not so. An inquiry into the merits of a void order is inescapable where, as here, the denial of a Rule 60(b) motion is under review. See *Brennan* v. *Midwestern United Life Ins. Co.*, 450 F.2d 999, 1003 (7th Cir. 1971), *cert. denied*, 405 U.S. 921 (1972) (inquiry into merits of arguably void order is unavoidable on appeal of denial of Rule 60(b) motion) (cited with approval in *Browder* v. *Director, Dept. of Corr.*, 434 U.S. 257, n.7 (1978)).

Here, the district court reversed the bankruptcy court's denial of USA Funds' Rule 60(b)(4) motion and granted relief, ruling that the confirmation order is void. Dist. Dkt. 11. Espinosa appealed that order, Dist. Dkt. 12, and the Ninth Circuit's reversal is now before this Court. Given USA Funds' contention that the confirmation order is void (to the extent of noncompliance with the Code), review of those prior

rulings and the merits of the underlying order is logically inseparable and properly before the Court.[1]

A. An Unlawful Confirmation Order Is Void, Not Merely Erroneous.

An order is void if the court, although having jurisdiction over the parties and the subject matter, nonetheless enters a decree "not within the powers granted to it by the law." *United States ex rel. Wilson*

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[1] Espinosa's *amici*, but not Espinosa, argue that the Court lacks subject-matter jurisdiction because USA Funds' Rule 60(b)(4) motion was not filed within the 180-day time limit set out in 11 U.S.C. § 1330(a). That argument is meritless. A time limit is not "jurisdictional" merely because it is prescribed by statute. Statutes are only jurisdictional if Congress says so. "[W]hen Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Arbaugh* v. *Y & H Corp.*, 546 U.S. 500, 516 (2006). That is the case here. Congress put no express jurisdictional designation on the time limit of section 1330(a). Instead, it set out a rule for revoking an order in an action over which the court already has jurisdiction. In that respect, section 1330(a) closely parallels the claim-processing rules held not to be jurisdictional in *Eberhart* v. *United States*, 546 U.S. 12 (2005), and *Kontrick* v. *Ryan*, 540 U.S. 443 (2004). As the Court explained in *Kontrick*, "a court's subject-matter jurisdiction cannot be expanded to account for the parties' litigation conduct; a claim-processing rule, on the other hand, * * * can nonetheless be forfeited if the party asserting the rule waits too long to raise the point." 540 U.S. at 456. That is precisely what happened here. Espinosa did not invoke section 1330(a) in the bankruptcy court, so that defense was forfeited long ago – and not even Espinosa seeks to resuscitate it now. The time limitation in section 1330(a) is not jurisdictional, and therefore does not bar the Court's review of the orders here.

v. *Walker*, 109 U.S. 258, 266 (1883). Accord *Vallely* v. *Northern Fire & Marine Ins. Co.*, 254 U.S. 348, 353-54 (1920); *Wilcox* v. *Jackson*, 38 U.S. 498, 511 (1839). Not surprisingly, Espinosa fails in his attempt to distinguish almost 200 years of precedent so holding.

In *United States ex. rel. Wilson* v. *Walker*, *supra*, the order directing the estate administrator to turn over monies that were not assets of the estate was held beyond the authority granted by the relevant statute – and therefore void. Similarly, the provision of the confirmation order here purporting to discharge a student loan debt without a finding of undue hardship is not authorized by the Code and is likewise void. 11 U.S.C. §§ 523(a)(8) and 1328(a)(2). Indeed, the bankruptcy court had no statutory authority to confirm a plan that was not in compliance with the Code. 11 U.S.C. § 1325(a)(1). For that reason, the bankruptcy court's confirmation of the plan providing for the discharge was not merely error in the *exercise* of authority, as Espinosa's *amicus* Trustees' Association argues. Br. at 27. It was done *without* authority – and was therefore void, just like the order in *Wilson*.

In *Vallely*, *supra*, the order resulting from the adjudication of an insurance company's bankruptcy was similarly beyond the court's authority – and thus void – because the pertinent statutes specifically excepted insurance companies from the benefits of bankruptcy. Espinosa attempts to distinguish *Vallely* by characterizing it as a personal jurisdiction case, but the case had nothing to do with personal

jurisdiction. As in *Vallely*, the statutes at issue here restrict the power of the bankruptcy court to act – in this case, to confirm a plan providing for discharge of student loan debt without a determination of undue hardship. That provision of the confirmation order is void, just like the order in *Vallely*.

Espinosa likewise fails to distinguish *Wilcox* v. *Jackson*, *supra*, which states the same rule as *Vallely* and the case on which they both rely, *Elliott* v. *Peirsol*, 26 U.S. 328 (1828). Indeed, his description of *Wilcox* makes USA Funds' point that unauthorized judicial acts are void. Br. at 28.

B. *Travelers* Does Not Bar USA Funds' Direct Attack On The Confirmation Order.

Espinosa does not dispute that USA Funds' Rule 60(b)(4) motion was a direct attack on the confirmation order that is not barred by *res judicata*. Espinosa's *amicus* goes further and *agrees* it is a direct attack. Br. of *Amicus* Pardo at 16, n.10. Nonetheless, Espinosa relies upon *Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195 (2009), which involved a *collateral* attack on an order for lack of subject matter jurisdiction, to argue that USA Funds' attack on the order is likewise barred. Espinosa is mistaken.

Travelers arose out of the Chapter 11 bankruptcy of asbestos manufacturer Johns-Manville Corporation in 1982. The bankruptcy court devised a reorganization plan involving a trust to be funded mostly by Manville's insurers, including Travelers. Essential to

the plan was the settlement of litigation between Manville and its insurers. Accordingly, the resulting settlement order enjoined all claims against the insurers "arising out of or related to" the policies, and released the insurers from such claims. That order, in turn, was incorporated in the 1986 orders confirming the plan of reorganization. Those orders were affirmed on appeal.

Years later, personal-injury plaintiffs filed suits in state courts against Travelers alleging various state-law claims based on the insurer's own misconduct. Invoking the 1986 orders, Travelers moved to enjoin the suits. The bankruptcy court ultimately approved a settlement between Travelers and some of the plaintiffs, held that the claims were barred by the 1986 orders, and entered an order clarifying the effect of those orders.

On appeal, the Second Circuit held that the bankruptcy court lacked subject matter jurisdiction to enjoin the claims against Travelers. This Court reversed, holding that the 1986 orders became final on direct review 20 years earlier, whether or not they were proper exercises of the bankruptcy court's jurisdiction. In reaching that conclusion, this Court rejected what it repeatedly characterized as a collateral attack on the 1986 orders. See, e.g., *id.* at 2206 ("The willingness of the Court of Appeals to entertain this sort of collateral attack cannot be squared with *res judicata* and the practical necessity served by that

rule."); *ibid.*, n.7 ("[T]his argument is an impermissible collateral attack.").

Unlike the collateral attack in *Travelers*, USA Funds' challenge here is a *direct* attack on the order – brought on the ground that the order's discharge of student loan debt is void. As Espinosa's *amicus* agrees, and he himself does not dispute, that challenge is a direct attack not barred by *res judicata*. See *Pepper* v. *Linton*, 308 U.S. 295, 302 (1939) (holding that *res judicata* did not prevent the court from "examining into the * * * judgment and disallowing or subordinating it as a claim" where the underlying judgment was claimed to be *void ab initio*). What is more, there was no issue in *Travelers* of any statutory limit on the court's power, as there is here. *Travelers* is therefore not apposite, much less dispositive.[2]

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[2] Like *Travelers*, this Court's decisions in *Celotex Corp.* v. *Edwards*, 514 U.S. 300 (1995), *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371 (1940), and *Stoll* v. *Gottlieb*, 305 U.S. 165 (1938), are collateral attack cases and thus inapplicable. *Amicus* Trustees' reliance on *Bell* v. *Eastman Kodak Co.*, 214 F.3d 798 (7th Cir. 2000), is similarly misplaced. See Trustees' Br. at 10-11. The movant in *Bell* "tried to use [the motion] to appeal a final judgment entered by one magistrate judge to another magistrate judge, rather than to the court of appeals." 214 F.2d at 800. Hence, it was characterized as a collateral attack. In contrast, USA Funds' Rule 60(b) motion was a direct attack on a void provision in a confirmation order.

II. THE UNDUE HARDSHIP REQUIREMENT IMPOSED BY CONGRESS IS SELF-EXECUTING, AND CREDITORS THEREFORE HAVE NO DUTY TO OBJECT TO AN UNLAWFUL PLAN PROVISION DECLARING A DISCHARGE OF THE NONDISCHARGEABLE DEBT.

The exception of student loans from discharge in bankruptcy is "self-executing" – that is, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Tennessee Student Assistance Corp.* v. *Hood*, 541 U.S. 440, 450 (2004). Accordingly, a creditor has no duty to object to an illegal plan provision declaring a discharge of the nondischargeable debt. Instead, the creditor may wait for the debtor to initiate the adversary proceeding required by the Bankruptcy Rules to secure an undue hardship determination as required by the Code.

Any attempt to discharge a student loan without a finding of undue hardship would not comply with section 523(a)(8). And compliance with the Code is a mandatory condition to confirmation of a plan. Therefore, a court cannot confirm a noncompliant plan even if no creditor objects to it. Absent a duty to object, the failure to do so cannot constitute a waiver of the express requirements of the Code and Rules. Espinosa and his *amici* raise a variety of challenges to that conclusion, but all lack merit.

A. It Is Immaterial To The Bankruptcy Court's Duty That The Determination Of Undue Hardship Required By Congress Is Not "Jurisdictional."

By statute, bankruptcy courts have an "independent duty to confirm only those Chapter 13 plans which comply with all the provisions of Chapter 13 (see 11 U.S.C. § 1325(a)(1))." *In re Fizer*, 1 B.R. 400, 402 (Bankr. S.D. Ohio 1979). Nonetheless, Espinosa's *amici* Professors argue that sections 523(a)(8) and 1328(a)(2) are not "jurisdictional" and thus need not be addressed *sua sponte* by bankruptcy courts. Br. at 12-14. That argument misses the larger point that by express statutory restriction, *only* plans that comply with the Code may be approved. Pet. Br. at 33-36. Any other result would be at odds with the text, purpose, and structure of the Code. *Id.* at 16-24.

In all events, this Court has consistently recognized that even though non-jurisdictional requirements may be subject to waiver, forfeiture, and equitable exceptions, see, e.g., *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. 385, 393 (1982), some requirements should be enforced more rigidly, *Hallstrom* v. *Tillamook County*, 493 U.S. 20, 23, 31 (1989), and therefore can be raised by the court on its own motion. *Day* v. *McDonough*, 547 U.S. 198, 205, 209 (2006). In making those determinations, the Court has focused on the relevant statutory language, other indicia of congressional intent, and the extent to which the requirements protect institutional or public interests beyond the interests of the parties to the

litigation. *Id.* at 205-206; *Hallstrom*, 493 U.S. at 28-29.

The last consideration – whether the rule serves broader systemic interests beyond the litigants' interests – is key. *Hallstrom*, 493 U.S. at 24-26, 28-29; *Day*, 547 U.S. at 205, 209. The statutes at issue here easily fit into that category. By making student loan debt presumptively nondischargeable, Congress sought to preserve the viability of educational loan programs and protect the public fisc. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, pt. I at 11, 170, 176-77; pt. II § 4-506(8) & note (1973). Similar interests are reflected in the public policy reasons animating the other exceptions to discharge. Pet. Br. at 46-47. In light of those considerations, bankruptcy courts should strictly enforce the undue hardship requirement and refuse to confirm a debtor's proposed plan to the extent it fails to comply with the Code by proposing the discharge of a student loan debt without a determination of undue hardship – even if the creditor has not objected.

That conclusion comports with this Court's holdings – in a variety of contexts – that where, as here, a rule or defense implicates extra-party interests, judicial enforcement of that rule is particularly appropriate. See, e.g., *Day*, 547 U.S. at 205-206, 209 (holding that because the habeas statute of limitations "implicate[d] values beyond the concerns of the parties," the court had discretion to raise the defense *sua sponte*) (citation omitted); *Arizona* v.

California, 530 U.S. 392, 412-13 (2000) (holding that because the *res judicata* defense "is not based solely on the defendant's interest in avoiding the burdens of twice defending a suit, but is also based on the avoidance of unnecessary judicial waste," a court "may dismiss the action *sua sponte*" on this ground); see also *United States* v. *Mitchell*, 518 F.3d 740, 749-751 (10th Cir. 2008) (same as to the time limitation in Federal Rule of Appellate Procedure 4(b)).

Congress has imposed a *duty* upon bankruptcy courts to confirm only those Chapter 13 plans that comply with the Code. See 11 U.S.C. § 1325(a)(1).[3] "To qualify for confirmation under Chapter 13, [a] plan ha[s] to satisfy the requirements set forth in § 1325(a) of the Code." *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953, 956 (1997). That duty requires courts to enforce the undue hardship requirement whether or not a creditor lodges an objection to a noncompliant – and thus unlawful – plan.

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[3] Congress has explicitly provided that bankruptcy courts may lodge *sua sponte* objections to enforce their own rules or prevent an abuse of process. 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.").

B. Even If Waiver Were Possible, No Waiver May Be Inferred Here.

Student loan debt is presumptively nondischargeable, the statutory exception from discharge is "self-executing," and "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Hood*, 541 U.S. at 450. A creditor therefore need not take any action to avoid a discharge. *In re Mansaray-Ruffin*, 530 F.3d 230, 236 (3d Cir. 2008) (discussed at Pet. Br. at 34). Under those circumstances, there can be no waiver of an objection where there is no duty to object in the first place.

That conclusion is confirmed by one of the cases upon which Espinosa relies. In *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), the bankruptcy trustee failed to object to the debtor's list of exempt property. Section 522(*l*) of the Code requires the debtor to submit a list of the property that is claimed to be exempt from the claims of creditors, and by placing the burden to object on creditors, makes any listed property exempt absent an objection:

> The debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section * * * * Unless a party in interest objects, the property claimed as exempt on such list is exempt.

A creditor who does not object therefore waives any objection to the claimed property exemptions. But unlike section 522(*l*), the statutes governing the

discharge of student loan debts place the burden on the *debtor* to take affirmative action to obtain a determination of undue hardship.

In that respect, section 522(*l*) operates more like section 523(c)(1), which provides that certain categories of debts that are not automatically excepted from discharge will be discharged unless the creditor seeks a determination of dischargeability.[4] Under section 523(c)(1), a creditor who fails to initiate an adversary proceeding to avoid the discharge of such a debt waives the right to prevent the discharge. That is not true as to student loan debt. See Br. of *Amicus* United States at 13-16. As the Seventh Circuit has explained in rejecting the argument Espinosa makes here, "[s]tudent loan creditors justifiably rely on the explicit notice provisions of the Code and Rules and have no reason to act until the service of a summons for an adversary proceeding apprises them that their property rights may be affected." *In re Hanson*, 397 F.3d 482, 486-87 (7th Cir. 2005).

Espinosa relies upon *Vallely* v. *Northern Fire & Marine Ins. Co.*, *supra*, but that case actually supports the proposition that there can be no waiver here. In *Vallely*, the creditors of an insurance company initiated bankruptcy proceedings against it.

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[4] In Chapter 13 cases, those categories of debts include credit fraud, fraud or defalcation while acting as a fiduciary, embezzlement, and larceny. 11 U.S.C. §§ 523(a)(2) and (4), 1328(a)(2).

Although the insurance company *knew* of the pending bankruptcy and its officers even assisted the trustee without questioning the propriety of the bankruptcy, the company was not estopped from later moving to vacate the adjudication as void. Likewise, USA Funds' knowledge of Espinosa's bankruptcy, and even of the proposed plan, does not support any inference of a waiver.

Nor can waiver be inferred based upon assumptions such as those made by the Ninth Circuit regarding what creditors think when reviewing a student loan debtor's schedules and plan. See Pet. App. 9-10. As a practical matter, there is simply too little information in the schedules and plan for the debtor to prove, or for the creditor to analyze, the rigorous elements of undue hardship – much less to support an inference that the creditor must have decided to waive any objection because it would be futile. Pet. Br. at 34-36.

C. The Then-Existing Regulations Did Not Require USA Funds To Review Or Object To Espinosa's Plan.

Espinosa and his *amici* Professors argue that federal regulations required USA Funds to review Espinosa's Chapter 13 plan for compliance with the Code. Respondent's Br. at 51-53; Professors' Br. at 19-21. That is incorrect. The cited regulations were not in effect until July 1, 2008 – long after Espinosa filed bankruptcy in 1992. The regulations that *were* in

effect when Espinosa filed bankruptcy did not require creditors like USA Funds to review plans for compliance with the Code. Instead, they only required a creditor, after receiving notice of the commencement of the bankruptcy, to file a proof of claim and inquire whether the debtor had filed a petition to have the student loan declared dischargeable "on grounds of undue hardship." 34 C.F.R. § 682.402(d). If so, the lender was required to file a claim with the guaranty agency, which was to contest the hardship discharge. 34 C.F.R. § 682.402(d) and (h). The regulations therefore explicitly contemplated that student loan debtors would follow proper procedure by filing an adversary proceeding.[5]

Although the new regulations do require guaranty agencies to review proposed Chapter 13 plans and to object if the plan does not meet the

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[5] Under the current regulations, which are misquoted out of context by Espinosa, the lender must, after receiving formal notice of the bankruptcy filing, 34 C.F.R. § 682.402(f)(3), file a proof of claim in the bankruptcy, 34 C.F.R. § 682.402(f)(4), and a claim with the guaranty agency. 34 C.F.R. § 682.402(f)(5). The lender is to provide to the guaranty agency any known information that might support an objection to the discharge. 34 C.F.R. § 682.402(g)(1)(v)(B). *Only* in the event of an undue hardship claim must the guaranty agency make its own assessment of undue hardship and a cost-benefit analysis of opposing the adversary proceeding discharge petition. 34 C.F.R. § 682.402(i)(1)(ii) and (iii). As before, the new regulations still explicitly contemplate that the debtor will follow proper discharge procedure by affirmatively seeking a hardship determination. See 34 C.F.R. § 682.402(f)(5)(i)(C) and 34 C.F.R. § 682.402(i)(1).

requirements of 11 U.S.C. § 1325, 34 C.F.R. § 682.402(i)(2), no waiver should be presumed from the lack of an objection because, as detailed by *amicus* National Council of Higher Education Loan Programs, the confirmation process often proceeds at a pace that prevents a timely objection. NCHELP Br. at 16-28. Even under the current regulations, because the statutory requirement of an undue hardship determination is self-executing, a court cannot confirm a noncompliant plan even if no creditor objects to it. 11 U.S.C. § 1325(a)(1).

III. ESPINOSA'S CONFIRMATION AND DISCHARGE ORDERS, ENTERED WITH NO DETERMINATION OF UNDUE HARDSHIP, ARE NOT FINAL AS TO USA FUNDS.

Espinosa ignores the discharge statute, 11 U.S.C. § 1328(a), which provides that after completion of the plan, the court shall grant the debtor a discharge "of all debts provided for by the plan * * * *except* any debt – * * * (2) of the kind specified in * * * section 523(a)[(8)] * * * " (Emphasis added). Thus, even a student loan debt "provided for" by a plan, such as Espinosa's debt, continues to be excepted from discharge.

Espinosa makes no effort to harmonize the specific exceptions to discharge enumerated in section 1328(a) with the more general language of section 1327(a), which describes the effect of confirmation. Nor does he dispute that the specific controls the general, that the two sections must be read to give

meaning to all of their terms, and that "[g]iving preclusive effect to a discharge-by-declaration through § 1327(a) renders part of § 1328(a)(2) nugatory." *Educational Credit Mgm't Corp.* v. *Mersmann (In re Mersmann)*, 505 F.3d 1033, 1048 (10th Cir. 2007).

Indeed, Espinosa does not challenge that there was *no* adjudication of the undue hardship issue on the merits prior to confirmation or discharge. He therefore effectively concedes that a discharge by declaration is not an adjudication on the merits. Thus, the confirmation and discharge orders do not have *res judicata* effect. Consequently, *res judicata* cases such as *Travelers* and *Chicot County Drainage Dist.* v. *Baxter State Bank*, *supra*, are inapposite.

The suggestion of Espinosa's *amici* that the issue of undue hardship might have been adjudicated when USA Funds filed a proof of claim is without merit. See Trustees' Br. at 10, n.4. The Trustees ignore that neither Espinosa nor his trustee objected to the claim. That lack of objection cannot be squared with a contention that a portion of the claim was discharged by some implicit adjudication of undue hardship. Furthermore, the Trustees' mention of the rule that a default judgment has *res judicata* effect is irrelevant because Espinosa did not commence an adversary proceeding as required, and USA Funds did not default.

Espinosa's argument that the amended discharge order is final is illusory. That order is, of course, dependent upon the underlying confirmation order.

Because the confirmation order is partially void, the subsequent discharge order is too, and subject to a Rule 60(b)(4) motion for that reason. An appeal from that discharge order challenging whether there was clerical error would have been pointless, as it would not reach the determinative issues that were already on appeal.

Espinosa's *amici* suggest that sanctioning attorneys would be preferable to vacating void orders. Trustees' Br. at 30-31 (citing *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992)). But that will not stop the practice of including unlawful provisions for the discharge of nondischargeable debts in Chapter 13 plans. Indeed, the Ninth Circuit disapproved one bankruptcy court's threat of sanctions for doing so. Pet. App. 25-26. Moreover, if the Ninth Circuit's decision in this case is affirmed, the practice will be "warranted by existing law" and therefore (unlike in *Taylor*) will not be sanctionable. FED. R. BANKR. P. 9011(b) and (c).

IV. AFFIRMING THE NINTH CIRCUIT WILL OPEN THE FLOODGATES TO DISCHARGE OF OTHER NONDISCHARGEABLE DEBTS BY MERE DECLARATION, CONTRAVENE PUBLIC POLICY, AND CAUSE SENSELESS WASTE.

Neither Espinosa nor his *amici* offer any response to the arguments of USA Funds (at Pet. Br. 43-51) and its *amici* concerning the important interests served by Congress' requirement of an adversary

proceeding to establish undue hardship before student loan debt may be discharged. They do not address the inevitable spread of discharge by declaration to other types of nondischargeable debts if the Ninth Circuit's decision is affirmed. And they do not deny that senseless waste will result if the burden to object to attempted discharges by declaration is imposed upon creditors.[6]

That silence is telling. If student loan debt discharge by declaration is approved, the tactic of discharge by declaration will no doubt spread in Chapter 13 cases to other nondischargeable debts, such as taxes, domestic support obligations, drunk driving personal injury and death liabilities, and criminal fines and restitution. Br. of *Amici* States at

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[6] With regard to the burden on creditors, Espinosa could not be more wrong in his suggestion that a corporate creditor can object *pro se* to a plan at the first meeting of creditors. Br. at 48. An objection to confirmation is beyond the scope of a creditor's meeting. See 11 U.S.C. § 341; FED. R. BANKR. P. 2003. "The chief function of the meeting of creditors is to provide the machinery for creditors to elect a trustee, examine the debtor and be heard generally in an advisory capacity on questions concerning the administration of the estate." 3 COLLIER'S ¶ 341.01, p. 341-4. Furthermore, the meeting is extra-judicial rather than a hearing. The trustee presides at the meeting and the court is expressly prohibited from presiding or attending. 11 U.S.C. § 341(a) and (c). Finally, an objection to confirmation must be filed as a "contested matter," FED. R. BANKR. P. 3015(f) and 9014, and a corporate creditor can only do so through counsel. *Rowland* v. *California Men's Colony*, 506 U.S. 194 (1993); FED. R. BANKR. P. 9010, 1983 Advisory Committee Note; 10 COLLIER'S ¶ 9010.07, p. 9010-5.

1-2; Pet. Br. at 43-45. That only underscores the absurdity of reading section 1327(a) in isolation to give finality to a confirmation order that illegally discharges a nondischargeable debt in defiance of numerous other Code provisions. On that view, a father could propose a Chapter 13 plan containing a provision declaring the discharge of his child support arrearages, mail it to the mother, and if she does not object, the plan will be confirmed and become forever final and immune even to a direct attack by a Rule 60(b)(4) motion.

There is no question that finality is an important policy. But other concerns are implicated here, as well. That is why, when deciding whether a particular aspect of a confirmation or discharge order is deserving of finality, it is essential to consider the nature of the debt discharged. In that regard, it is decisive that "[t]he statutory provisions governing nondischargeability reflect a congressional decision to exclude from the general policy of discharge certain categories of debts – such as child support, alimony, and certain unpaid educational loans and taxes, as well as liabilities for fraud." *Grogan* v. *Garner*, 498 U.S. 279, 287 (1991). Because "Congress evidently concluded that creditors' interests in recovering full payment of debts in these categories outweighed the debtors' interest in a complete fresh start," *ibid.*, it necessarily follows that Congress did not intend to give finality to the discharge of a student loan debt without a finding of undue hardship, or to give finality to the discharge of a nondischargeable debt

(e.g., child support) that the court had no authority to discharge in the first instance.

The consequences of a contrary holding are serious and far reaching. That is particularly true with respect to municipalities already dealing with stretched budgets and shortfalls. See Br. of *Amicus* Int'l Municipal Lawyers at 3-4. Because tax obligations are always nondischargeable if they fall within 11 U.S.C. § 523(a)(1), many small municipalities do not expend scarce resources retaining bankruptcy counsel for Chapter 13 proceedings, in reliance on the rule that plans containing impermissible provisions affecting nondischargeable tax obligations will be deemed void. *Ibid.* But if Espinosa prevails, that presumption will fall by the wayside, and municipalities must either expend scarce resources objecting to facially deficient Chapter 13 plans, or risk losing valuable tax revenue. *Id.* Such untoward results, and others like them, Pet. Br. 43-45, are entirely unnecessary and easily avoided by adhering to the existing framework that plans may not be confirmed if inconsistent with the Code and Rules.

V. CONGRESS HAS PRESCRIBED THE LEVEL OF NOTICE DUE TO USA FUNDS, WHICH ESPINOSA FAILED TO PROVIDE.

Discharge by declaration is not only inconsistent with the Code, it is also contrary to the constitutional safeguard of due process. In arguing to the contrary, Espinosa simply misapprehends USA Funds' due

process argument. There is no question that Congress could have allowed discharge of student loans with lesser procedural protections. But once Congress specified heightened procedural protections, the Constitution prohibits depriving persons of property without the process that is due. Congress specified the process that was due – here, a judicial determination of "undue hardship," within the context of the adversary proceeding required by the Rules.[7] Congress also specified the level of notice due – "such notice as is appropriate in the *particular* circumstances." 11 U.S.C. § 102(1)(A) (emphasis added). Discharging a student loan debt with any less process and notice runs afoul of the protections of due process.

The adversary proceeding is prescribed by the Bankruptcy Rules, which in turn are promulgated by this Court under 28 U.S.C. § 2075. An adversary proceeding is commenced by the filing of a complaint, FED. R. BANKR. P. 7003 (incorporating FED. R. CIV. P. 3), that must be served with a summons. FED. R. BANKR. P. 7004. Service upon a corporation, such as USA Funds, must be made upon "an officer, a managing or general agent, or to any agent authorized by appointment or by law to receive service of process." FED. R. BANKR. P. 7004(b)(3). An adversary proceeding thus requires a "heightened degree of

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[7] Steven L. Thomas, *Do the Federal Rules of Bankruptcy Procedure Define Procedural Due Process Rights in Bankruptcy?*, 9 Norton Bankr. L. Adviser 2 (2009).

notice." *Banks* v. *Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296, 303, n.4 (4th Cir. 2002).

In contrast, notice of the confirmation hearing of a Chapter 13 plan need only include a summary of the plan, not the actual plan. FED. R. BANKR. P. 3015(d). And notice need only be sent by mail to creditors at the addresses provided by the debtor on his or her list of creditors. FED. R. BANKR. P. 2002(g)(2). Notice of a proposed plan thus does not require specific notice of the effect of the plan on each creditor, and it does not require notice to be served on a person at any particular level of responsibility. The notice requirements to initiate an adversary proceeding are thus far more exacting than the notice required for confirmation of a Chapter 13 plan. *Hood*, 541 U.S. at 451-52.

Because Congress has said that the level of notice given must be such "as is appropriate in the particular circumstances," the objective of the proceeding must be one of the circumstances considered when judging the sufficiency of the notice given. When the discharge of a student loan debt is the objective, the level of notice required is the same whether the debtor attempts to declare a discharge in a proposed plan, or proceeds by motion (if that were possible) or through an adversary proceeding. The level of notice required by section 102(1)(A) is guided by the Rules. 2 COLLIER'S ¶ 102.02[1], p. 102-4. Therefore, the notice appropriate to obtain a discharge of a student loan debt is service of a summons and complaint on a corporate officer or

authorized agent. FED. R. BANKR. P. 7003-7004. Where discharge of a student loan is the objective of a proposed plan, giving only the level of notice required to confirm a plan that does not seek that objective is insufficient.

Respondent's plan – which made no mention of undue hardship or its requisite elements and thus was not even the "functional equivalent" of a complaint – was merely mailed to petitioner at the post office box address at which it received loan payments. Although petitioner received such minimal notice of petitioner's plan, it was not given the notice and opportunity to be heard that Congress has prescribed to be due.

Contrary to Espinosa's characterization of it, USA Funds' argument is not that if Congress chose to allow discharge by declaration, the Constitution would forbid it. But that is not what Congress has done. Rather, the Code and Rules establish heightened procedural protections for the discharge of student loan debts, and due process requires that those protections be given full force. *City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293 (1953). Espinosa's failure to satisfy the heightened notice standard deprived USA Funds of the notice deemed appropriate by Congress and the Rules and constitutes a denial of due process. "[W]hen notice is a person's due, process which is a

mere gesture is not due process." *Mullane* v. *Central Hanover Bank & Trust*, 339 U.S. 306, 315 (1950).[8]

That USA Funds had knowledge of Espinosa's bankruptcy and received his proposed plan containing the discharge by declaration provision is immaterial. As this Court has explained, "even creditors who have knowledge of a reorganization have a *right* to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred." *City of New York*, 344 U.S. at 297 (emphasis added). Absent such notice, the unauthorized discharge provision of the resulting confirmation order is void.

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[8] USA Funds' *amicus* National Council of Higher Education Loan Programs, Inc. well describes in practical terms how student loan lenders and guaranty agencies are denied the notice and process they are due. NCHELP Br. at 16-28.

CONCLUSION

For the foregoing reasons and those in USA Funds' brief on the merits, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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